

March 2018

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Executive Summary

- ❖ The Normandy Contact Group issued a resolution to introduce a ceasefire in Donetsk and Luhansk prior to the Orthodox Easter. This is a first time when the Russian leadership publicly supported a ceasefire in Ukraine.
- ❖ The National Bank of Ukraine liberalized the exchange rate regime and reduced barriers to capital movement. This long overdue liberalization sends positive signal for investors.
- ❖ Ukraine and Israel agreed to sign a bilateral Free Trade Agreement in the nearest future. The negotiations for this deal were finalized in March.
- ❖ According to the latest release of the State Statistics Committee, the economic performance of Ukraine has continued to improve. In fact, real GDP grew by 2.5% in 2017, as we had originally predicted, compared to 2.3% in 2016. The major sources of GDP growth were gross capital formation, which increased by 9% yoy, household consumption, which increased by 7.8%, and government expenditures, which grew by 3.3% yoy.
- ❖ High-frequency data show that economic performance was satisfactory in February, with retail trade turnover increasing by 5.6% yoy, passenger turnover increasing by 3.7% yoy, and manufacturing increasing by 3.4% yoy. Within industrial manufacturing, the largest increases took place in the following sub-sectors: chemicals (43.1% yoy); furniture (16.6% yoy); coke and refined petroleum (6.3% yoy); engineering (5.9% yoy); metals (4.6% yoy); wood (4.2% yoy); and pharmaceutical products (1.9% yoy).
- ❖ The cumulative consolidated fiscal budget surplus (state and local) from the beginning of the year amounted to UAH 15.3 billion.
- ❖ Consumer inflation declined slightly in February to 14.0% yoy.
- ❖ In the banking sector, both national and foreign currency deposits expanded in February. Lending activities of commercial banks have also improved.
- ❖ The UAH/USD exchange rate appreciated by around 2.1% in March ending the month at around 26.23 UAH/USD.
- ❖ The current account of the balance-of-payments of Ukraine was close to equilibrium, with a small USD 9 million surplus, compared to a USD 133 million deficit in February 2018. The financial account also had net inflows of USD 243 million, compared to USD 102 million in February 2017. The major inflow were due to a trade credits (USD 453 million). As a result, the surplus of the overall balance of payments amounted to USD 252 million. This surplus allowed to increase its international reserves to USD 18.4 billion (3.6 months of imports).

Main Macroeconomic Indicators	2012	2013	2014	2015	2016	2017e	2018f
GDP, USD billion	173	180	130	87	93.4	104	110
Real GDP Growth, % yoy	0.2	0.0	-6.6	-9.9	2.3	2.5	3.0
Fiscal Balance (incl. Naftogaz/Pension Fund), % of GDP	-5.5	-6.5	-11.7	-2.1	-2.3	-1.5	-2.5
Public Debt, External and Domestic, % of GDP	36.6	40.4	69.4	79.1	81.2	78.5	78.0
Consumer Inflation, eop, % yoy	-0.2	0.5	24.9	43.3	12.4	13.7	9.0
Hryvnia Exchange Rate per USD, eop	8.1	8.2	15.8	24.0	27.1	28.1	29.0
Current Account Balance, % of GDP	-8.3	-9.2	-3.5	-0.2	-3.8	-3.7	-3.5
FDI, Net Annual Inflow, USD billion	8.4	4.5	0.4	3.0	3.3	2.3	5.0
International Reserves, USD billion	24.5	20.4	7.5	13.3	15.5	18.8	21.0
Public External Debt, USD billion	32.1	31.7	34.9	42.6	42.5	47.0	52.0
Private External Debt, USD billion	102.3	110.3	91.2	76.0	69.9	67.0	72.0

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Political and Reform Developments

On March 29, the countries of the Normandy Contact Group (Germany, Russia, Ukraine and France) issued a resolution to introduce a ceasefire in Donetsk and Luhansk prior to the Orthodox Easter, which is broadly observed by most of the populations of Russia and Ukraine. This is a thirteenth ceasefire resolution since the beginning of the antiterrorist operations against Russian-backed separatists. In the past, the Russian political leadership never supported a ceasefire publicly, since it denied its connection with the separatists. However, for the first time, the support for the introduction of the Eastern ceasefire came from the side of the Russian President in a public announcement. It might be a signal that the Russian administration may want to get more engaged in the military actions in the Eastern part of Ukraine.

Ukrainian international partners and local civil society continue their campaign against widespread corruption and demand concrete actions. In the last week of March, the head of the National Anticorruption Bureau (NABU), announced that the Agency was ready to pass dozens of cases to the Anti-Corruption Prosecutor (ACP) office for further legal action. But the NABU indicated that it has evidence that shows that the ACP is involved in criminal practices. The ACP responded with similar claims, blaming the NABU and the General Prosecutor Office of corruption. Obviously, this conflict is negatively affecting the perception of the population about the credibility of the new anticorruption institutions. It is expected that international arbiters may try to resolve these conflicts.

In March, the National Bank of Ukraine liberalized the exchange rate regime and reduced barriers to capital movement. According to the new Law (i) all commercial banks will be able to trade currencies on the interbank market freely without limitations, (ii) transferring capital in and out of the country will be less regulated, and (iii) the local population will face no obstacles to transfer money to and from abroad. This long overdue liberalization should be a positive signal for investors to help increase FDI inflow to Ukraine.

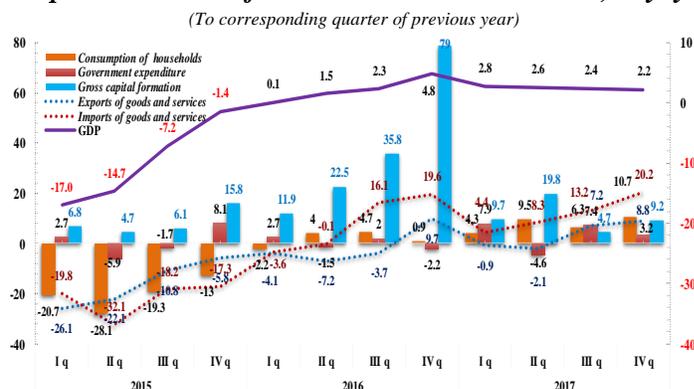
The Cabinet of Ministers decided to postpone increases in household gas prices for at least two months. The IMF has made the resumption of aid to Ukraine contingent on Kyiv gradually raising household gas prices to close the current 30% price gap with imported gas. Therefore it's unlikely that IMF will disburse the next tranche within the next two months.

Ukraine and Israel agreed to sign a bilateral Free Trade Agreement in the nearest future. The negotiations for this deal were finalized in March. This agreement has been under negotiation since 2013. In 2017, the total bilateral trade turnover was almost \$800 million. After the Agreement is in place the amount of trade is expected to increase substantially.

Economic Growth

According to the latest release of the State Statistics Committee, the economic performance of Ukraine has continued to improve. In fact, real GDP grew by 2.5% in 2017, as we had originally predicted, compared to 2.3% in 2016. The mayor sources of GDP growth were gross capital formation, which increased by 9% yoy, household consumption, which increased by 7.8%, and government expenditures, which grew by 3.3% yoy. At the same time, Ukrainian export of goods and services showed an increase of 3.5% yoy, while import growth slowdown to 12.2%.

Expenditure Side of the Gross Domestic Product, % yoy



Source: State Statistics Committee, The Bleyzer Foundation

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On the supply side of GDP, in 2017 the sectors that showed the stronger recovery were the construction sector (which expanded by 26.9%), real estate activities (7.8%), information and communication (7.7%), manufacturing (5.1%), and the wholesale and retail trade (5%). On the other hand, the following subsectors had negative rates of GDP growth in 2017: water supply, sewerage and waste management sector (-7.3%); electricity, gas, steam and air conditioning supply (-6.1%), mining and quarrying (-5.9%), and agriculture (-2.5%).

More frequent monthly output data show that in February 2018, economic performance was satisfactory, with retail trade turnover increasing by 5.6% yoy, passenger turnover increasing by 3.7% yoy, and manufacturing increasing by 3.4% yoy. On the other hand, Ukrainian freight turnover declined by -6.5% yoy, and construction output dropped by -2.3% yoy.

Within industrial manufacturing, the largest increases took place in the following sub-sectors areas: chemicals (43.1% yoy); furniture (16.6% yoy); coke and refined petroleum (6.3% yoy); engineering (5.9% yoy); basic metals (4.6% yoy); wood & paper (4.2% yoy); and basic pharmaceuticals (1.9% yoy). On the other hand, the highest drops in industrial output were experienced in the production of foodstuffs (-4.6% yoy); electricity, gas, steam, air conditioning supply (-3.8% yoy); and textiles (-1.4% yoy).

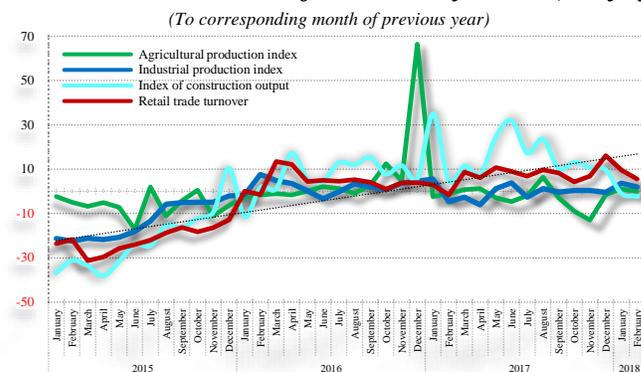
Regarding regional industrial output, the highest growth took place in the following oblast in February 2018: Ivano-Frankivsk (20.9% yoy), Sumy (18.3% yoy), Lviv (10.5% yoy), Kirovohrad (10.4% yoy), Kyiv (10.3% yoy), and Volyn (10.1% yoy). On the other hand, negative rates of growth in industrial output were experienced in nine regions as follows: Luhansk (-32% yoy), Chernihiv (-11.8% yoy), Ternopil (-8.3% yoy), Donetsk (-6.8% yoy), Rivne (-5.2% yoy), Kherson (-4% yoy), Poltava (-2.6% yoy), Cherkasy (-2% yoy), Vinnytsya (-1.9% yoy) and Kyiv city (-1.4% yoy).

Fiscal Policy

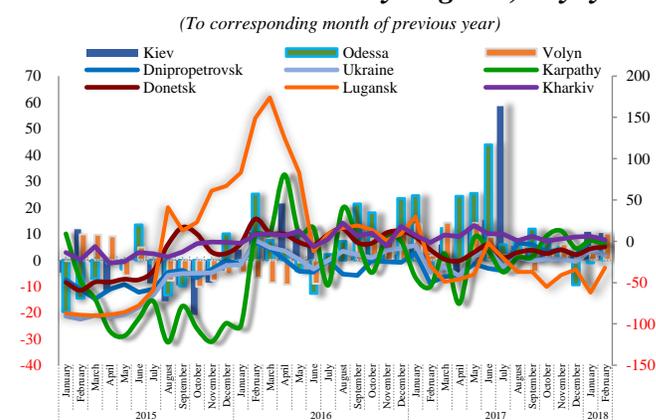
The state budget was executed with a deficit of UAH 9.5 billion in February. The reason was a slower increase in state budget revenues than in expenditures. On the other hand, local budgets were executed with a surplus of UAH 4.2 billion despite a decline in revenues due to cuts in official transfers. Thus, the consolidated budget balance was negative at UAH 5.3 billion in February. However, the cumulative consolidated budget balance from the beginning of the year was a surplus of UAH 15.3 billion.

State budget revenues returned to growth in February, expanding by 7.0% yoy. Tax revenues increased by 8.3% yoy, while nontax revenues contracted by 3.5% yoy. Growth of receipts from personal income taxes (22.4% yoy)

Ukraine Economic Performance by Sector, % yoy



Industrial Production by Regions, % yoy



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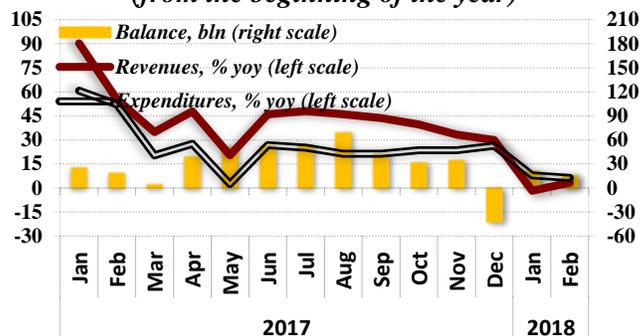
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and the VAT (62.7% yoy) more than compensated for declines in receipts from corporate profit taxes (29.7% yoy) and excise taxes (10.0% yoy).

As for State budget expenditures, in February 2018 there were contractions in current transfers (12.1% yoy), social security expenditures (16.3% yoy), and expenditures on state debt servicing (7.8% yoy). But these contractions were offset by significant increases in payroll expenditures (34.3% yoy), expenditures on goods and services (46.5% yoy), and capital expenditures (215.9% yoy).

In February, the Ukrainian government paid USD 536.8 million on its external liabilities. This included USD 465.9 million paid to the IMF. Non-IMF principal and servicing payments on state and guaranteed debt denominated in foreign currency amounted USD 70.9 million, including USD 16.0 million of servicing interest payments on sovereign bonds. From March to the end of 2018, Ukraine's government has to pay USD 2.0 billion of principal and interest payments to the IMF. Principal payments for 2018 to be paid from the state budget amount to USD 2.1 billion equivalent (IMF – USD 1.5 billion equivalent, IBRD – USD 284.6 million equivalent, and EBRD - USD 130.3 million equivalent). The NBU has to pay USD 0.7 billion of principal payments on external debt in 2018. Thus total general government principal payments on external debt are equal to USD 2.8 billion equivalent. As for interest payments on external debt in 2018, they will amount to USD 1.7 billion equivalent. This includes USD 932 million equivalent on restructured sovereign bonds of 2015, USD 227.3 million equivalent on restructured sovereign bonds of 2017, USD 177.6 million equivalent on the IMF loans, and USD 106 million equivalent on the IBRD loans. The total amount of principal and interest due in 2018 by the general government and NBU will amount to USD 4.5 billion. The government will need to revive IMF lending during the course of the year to maintain foreign exchange stability.

**Dynamics of Consolidated Budget Components
(from the beginning of the year)**



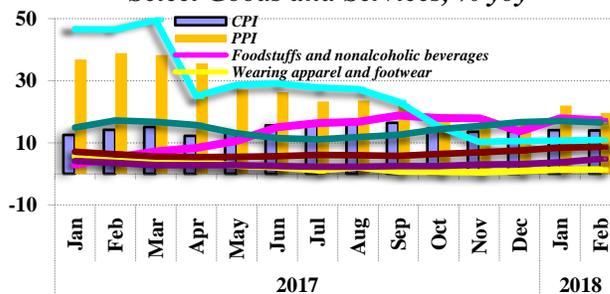
Source: The Ministry of Finance of Ukraine, The Bleyzer Foundation

Monetary Policy

Inflation. Consumer inflation slightly decelerated in February, with the all items index inching down to 14.0% yoy. This rate is above expectations because of faster growth of whole foods and fuel. But core inflation slightly decelerated to 9.7% yoy.

There were small changes in prices of all the major groups of goods and services in February. The largest change was a 1.1 percentage point acceleration in growth of household appliance prices to 4.8% yoy. In addition, there were a 0.6 percentage point deceleration in growth of foodstuffs prices to 17.3% yoy, a 16.5% yoy growth of transport prices, and a 4.6% yoy growth of prices for recreation and culture. The rest of the major groups of goods and services saw smaller or no changes in price dynamics in February. Although consumer inflation in February was slightly above the expectations, we leave our forecast unchanged at 10% yoy for 2018.

**CPI, PPI, and Growth of Prices for
Select Goods and Services, % yoy**



Source: State Statistical Service of Ukraine, The Bleyzer Foundation

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Banking Sector.

In February, deposits posted increases in both national currency and foreign currency segments. National currency deposits expanded by 17.2% yoy, mainly due to increasing household deposits, which increased by 21.8% yoy. These deposit increases were supported by expanding nominal population incomes and stronger Hryvnia. Corporate national currency deposits also increased by 9.4% yoy although companies had to pay quarterly taxes. Growth of the foreign currency deposits denominated in USD accelerated by 0.7 percentage points to 8.6% yoy also thanks to household sector.

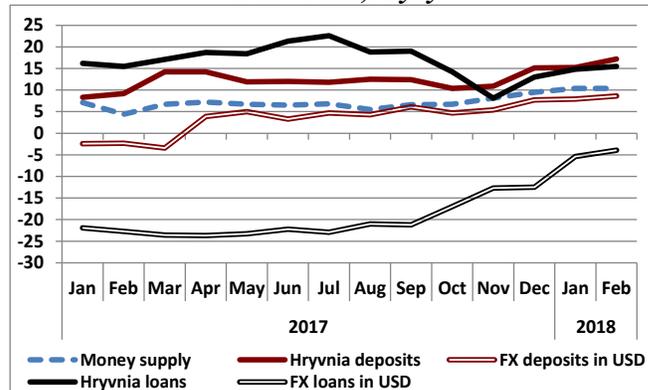
On the lending side, both national and foreign currency lending activities improved in February. Growth of hryvnia loans accelerated during the month, while the decline of the foreign currency loans denominated in USD decelerated. A 15.5% yoy increase in national currency loans was the result of faster growth in both household (42.3% yoy) and corporate (11.2% yoy) loans. Similarly, both sectors made their contribution into deceleration of decline in foreign currency loans. Overall, total foreign currency deposits contracted by 3.9% yoy.

The increase in balances at the correspondent account of banks and in cash resources caused a 3.2% mom growth in the monetary base. The year-over-year growth of monetary base accelerated to 12.0%. On the other hand, money supply decreased by 0.5% mom, bringing the year-over-year increase to 10.4% yoy.

Hryvnia Exchange Rate. The UAH/USD exchange rate remained on an appreciation trend during the first half of March. Then, rapid growth in hryvnia resources of banks reversed the trend. Starting on March 19th and by the end of the month the exchange rate remained relatively stable except for the last three trading sessions of the month when exporters started a depreciatory trend by lowering dollar supply. Overall, the exchange rate appreciated from around 26.8 UAH/USD to around 26.2 UAH/USD or by 2.1%.

Taking into account recent developments at the foreign exchange market, the NBU decided to continue liberalization of foreign exchange markets and softened previously introduced temporary administrative restrictions. First, the regulator doubled the balance of foreign exchange operations and operations with banking metals to 1.0% of regulatory capital. Second, the NBU changed the limits of open short and long foreign exchange positions which will allow banks to manage risks more efficiently. Third, the regulator further softened restrictions on early repayment of foreign currency loans. Also the regulator further expanded the list of operations excluded from obligatory sale of foreign exchange and simplified the procedure of transferring foreign exchange abroad for operations related to execution of court decisions.

Dynamics of Money Supply, Deposits, and Loans, % yoy



Source: The NBU, The Bleyzer Foundation

Dynamics of the Average Weighted UAH/USD Exchange Rate in the Interbank Forex Market



Source: The NBU, The Bleyzer Foundation

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International Trade and Capital

In February 2018, the current account of the balance-of-payments of Ukraine was close to equilibrium, with a small USD 9 million surplus, compared to a USD 133 million deficit in February 2017. The February 2018 surplus was composed of a deficit of USD 733 million in goods, and surpluses of USD 93 million in services, USD 343 million in primary income, and USD 306 million in secondary income. This improvement was also due to the fact of goods exports increased by a larger percentage (10.6% yoy) than imports (9.5% yoy). Similarly, export of services increased at a faster pace (12.2% yoy), than service imports (7% yoy).

Exports of goods amounted to USD 3,296 million in February 2018, compared to exports of USD 2,979 million a year ago. Exports increased in all major products, including: chemicals (44.8% yoy); timber & wood products (39.7% yoy); industrial goods (26.9% yoy); metallurgy (23.8% yoy); minerals (3.3% yoy); and food products (2.7% yoy). However, Ukrainian export of machinery and equipment (-3%) together with informal trade (-12.3% yoy) showed negative signs.

Geographically, in January-February 2018, Ukrainian goods exports to Russia fell by 8.2% yoy, thus reducing Russia's share to 6.5% from 8.3% year ago. Exports to Europe increased by 37.2% yoy and now amount to 40.8% of exports (compared to 34.7% in Jan-February 2017). Exports to Asia increased by 4.7% yoy, representing 30.8% of total Ukrainian exports.

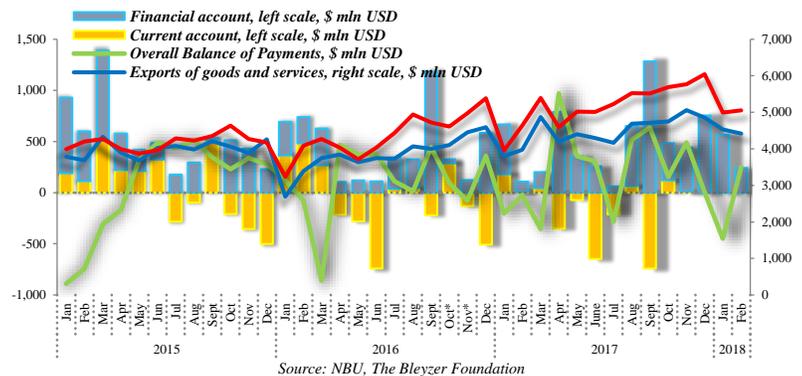
Imports of goods amounted to USD 4,029 million, compared to USD 3,679 million in February 2017. The major increase took place in machinery and equipment with 28.9% yoy growth. These products represented the highest share of total imports, reaching 27% of the total (22.9% in February 2017). The second largest product category, chemical imports, increased by 9.3% yoy, with the same share of 21.9% of total imports. The third position took place in mineral products, which fell by 16.4% yoy, with their share declining to 19.6% from 25.7% in February 2017. Food imports represent the fourth largest import group (11.3% of the total), with increases of 19.4% yoy.

Geographically, the share of imports from Russia to Ukraine has increased to 15.8% of the total amount, with a growth rate of 24.7% yoy in Jan-February 2018. Europe is the largest supplier of goods to Ukraine, with a 39.1% share (11.1% yoy growth), followed by Asia, with a 21.2% share (31.2% yoy growth). America also increased its share of imports to 7.5%, with 32.6% yoy growth in Jan-February 2018.

In February 2018, the financial account showed net inflows of USD 243 million, compared to USD 102 million in February 2017. The major inflow in February were due to a trade credits (USD 453 million). At the same time, foreign direct and net portfolio investments amounted USD 111 million and USD 207 million, respectively.

Thanks to the surplus in the financial accounts, the surplus of the overall balance of payments amounted to USD 252 million. This surplus allowed the NBU to increase its international reserves to USD 18.4 billion, sufficient to cover 3.6 months of imports.

**Ukraine's External Balance of Payments,
million USD**



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